DEPARTMENT OF STATE REVENUE

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Letter of Findings Number: 04-20110421
Sales and Use Tax
For Tax Years 2008 and 2009

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ISSUES

I. Sales and Use Tax–Software Licenses and Subscriptions.

Authority: IC § 6-2.5-1-27; IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-2.5-3-4; IC § 6-8.1-5-1; 45 IAC 2.2-4-1; Sales Tax Information Bulletin 8 (May 2002); Sales Tax Information Bulletin 8 (November 2011); Lafayette Square Amoco, Inc. v. Indiana Dep't of Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Indiana Dept. of State Revenue v. Kimball Int'l Inc., 520 N.E.2d 454 (Ind. Ct. App. 1988); Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp., 310 N.E.2d 96 (Ind. Ct. App. 1974).

Taxpayer protests use tax assessments on certain software purchases, and on online database subscriptions.

II. Sales and Use Tax–Imposition.

Authority: Sales Tax Information Bulletin No. 2 (December 2006); Wholesalers, Inc. v. Indiana Department of State Revenue, 597 N.E.2d 1339 (Ind. Tax Ct. 1992).

Taxpayer protests the imposition of sales tax on its purchase of software maintenance agreements.

STATEMENT OF FACTS

Taxpayer is an Indiana corporation that provides legal services, and has several office locations in the state.

The Indiana Department of Revenue (Department) conducted a sales and use tax audit for the 2008 and 2009 tax years (Tax Years). The Department's audit examination resulted in sales or use tax assessments on some of Taxpayer's purchases. Taxpayer protests the assessment of sales and use tax. A hearing was held and this Letter of Findings results. The Department will supply additional facts where applicable.

ISSUES

I. Sales and Use Tax–Software Licenses and Subscriptions.

DISCUSSION

IC § 6-8.1-5-1(c) provides that "[t]he notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." Lafayette Square Amoco, Inc. v. Indiana Dep't of Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007).

A. Software Licenses

During the Tax Years, Taxpayer purchased a number of licenses for software from different vendors. Taxpayer argues that it only acquired a license to store and retrieve information. Taxpayer also asserted that its purchases only allowed additional users to access the information.

Pursuant to IC § 6-2.5-2-1, a sales tax, known as state gross retail tax, is imposed on retail transactions made in Indiana unless a valid exemption is applicable. Retail transactions involve the transfer of tangible personal property. IC § 6-2.5-3-2(a). A complementary excise tax, known as the use tax, is imposed on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction. IC § 6-2.5-3-2. A taxpayer enjoys an exemption from the use tax for transactions where the gross retail tax ("sales tax") was paid at the time of purchase pursuant to IC § 6-2.5-3-4.

Expanding on the aforementioned statutes, IC § 6-2.5-2-1 provides:

> (a) An excise tax, known as the state gross retail tax, is imposed on retail transactions made in Indiana.
> (b) The person who acquires property in a retail transaction is liable for the tax on the transaction and, except as otherwise provided in this chapter, shall pay the tax to the retail merchant as a separate added amount to the consideration in the transaction. The retail merchant shall collect the tax as agent for the state.

And IC § 6-2.5-3-2 (a) states:

> An excise tax, known as the use tax, is imposed on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction.

45 IAC 2.2-4-1(a) further instructs that "[w]here ownership of tangible personal property is transferred for a consideration, it will be considered a transaction of a retail merchant constituting selling at retail unless the seller is not acting as a "retail merchant."

In this case, the audit found that Taxpayer should have paid sales tax on the software purchases, or self-assessed use tax based upon Taxpayer's incorporation of the software into its business.

However, Taxpayer argues that its software license purchases either involve access and storage services, or

additional individual access rights. The purchases do not involve the acquisition of tangible personal property. The definition of "tangible personal property" in IC § 6-2.5-1-27 clearly provides otherwise:

> "Tangible personal property" means personal property that:
>
> (1) can be seen, weighed, measured, felt, or touched; or
>
> (2) is in any other manner perceptible to the senses.
>
> The term includes electricity, water, gas, steam, and **prewritten computer software.**
>
> (**Emphasis added**).

Furthermore, Sales Tax Information Bulletin 8 (May 2002), 25 Ind. Reg. 3934, stated the general rule that:

> [T]ransactions involving computer software are not subject to Indiana Sales or Use Tax provided the software is in the form of a custom program specifically designed for the purchaser. Pre-written programs, not specifically designed for one purchaser, developed by the seller for sale or lease on the general market in the form of tangible personal property and sold or leased in the form of tangible personal property are subject to tax irrespective of the fact that the program may require some modification for a purchaser's particular computer. Pre-written or canned computer programs are taxable because the intellectual property contained in the canned program is no different than the intellectual property in a videotape or a textbook.

Sales Tax Information Bulletin 8 (November 2011), 20111228 Ind. Reg. 045110765NRA, now provides that:

> Prewritten computer software maintained on computer servers outside of Indiana also is subject to tax when accessed electronically via the Internet (i.e., "cloud computing"). The accessing of prewritten computer software by Indiana residents constitutes a transfer of the software because the customers gain constructive possession and the right to use, control, or direct the use of the software.
>
> Example #3: An Indiana resident purchases a new computer that enables the purchaser to access prewritten computer programs maintained on a third party's computer servers located outside of Indiana. The purchaser never receives the software in a tangible medium. Instead, the purchaser's software, including any documents created with the software, is housed on the third party's server. The sales of these programs are subject to tax.

In applying any tax exemption, "tax exemptions are strictly construed in favor of taxation and against the exemption." Indiana Dept. of State Revenue v. Kimball Int'l Inc., 520 N.E.2d 454, 456 (Ind. Ct. App. 1988). A statute which provides a tax exemption is strictly construed against the taxpayer. Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp., 310 N.E.2d 96, 97 (Ind. Ct. App. 1974). "[W]here such an exemption is claimed, the party claiming the same must show a case, by sufficient evidence, which is clearly within the exact letter of the law." Id. at 100-101.

During the audit, the Department asked Taxpayer to provide copies of contracts or other documents showing terms of the various software licenses, as well as invoices. In one instance, Taxpayer told the Department that Taxpayer would contact one of the third party software vendors to determine if that third party had charged Taxpayer sales tax. Taxpayer did not submit documents in response to the Department's request, nor any follow up information regarding that third party vendor.

During the hearing, Taxpayer requested additional time to provide a binder (or similar) compilation of invoices showing purchases subject to Taxpayer's protest, and a highlighted copy of the Department's audit workpapers designating those same protested purchases. Taxpayer provided the latter, which merely highlighted the specific purchases Taxpayer argued should enjoy sales or use tax exemptions. Taxpayer did not give the Department the proffered compilation of invoices, nor other documents evidencing the purchases.

Despite Taxpayer's contention that Taxpayer only acquires storage services or access rights, Taxpayer has not presented any documents or other evidence showing that Taxpayer's acquisitions fall outside IC § 6-2.5-1-27's definition of tangible personal property. Taxpayer has not met its burden to show that Taxpayer's software license purchases should enjoy an exemption from use tax. The software licenses are not exempt from sales tax as intangible items because they are tangible personal property pursuant to IC § 6-2.5-1-27.

B. Online Database Subscriptions

Taxpayer utilized a number of online databases accessed via the Internet. The audit determined that Taxpayer owed use tax on these database subscriptions.

Taxpayer argues that its use of these databases for online search and retrieval of information is use of services, and, therefore, as with its acquisition of software, should not be considered the purchase of tangible personal property.

Taxpayer singles out Accurint and LexisNexis as examples of online services used to identify case law and other legal materials and publications, and/or background information on individuals or real property. These two providers monitor and manage data, giving their respective customers customizable reporting through their websites in exchange for a fee. Taxpayer asserts that because it did not receive the transfer of property that has been compiled or packaged for sale to the general public, the service fees charged by Accurint and LexisNexis are not subject to sales or use tax.

Revisiting Sales Tax Information Bulletin 8 (May 2002), 25 Ind. Reg. 3934, for this issue:

> The sale of statistical reports, graphs, diagrams or any other information produced or compiled by a computer and sold or reproduced for sale in substantially the same form as it is so produced is considered to be the

> sale of tangible personal property unless the information from which such reports was compiled was furnished by the same person to whom the finished report is sold.

Accordingly, a taxpayer purchases a service when a service provider takes the taxpayer's information, reorganizes it into a new format, and returns the newly organized information to the taxpayer. However, a taxpayer purchases tangible personal property from a vendor when the vendor compiles or packages the vendor's own information for sale to the general public. Any transfer of this type of property in any format, electronic or otherwise, is subject to sales and use tax.

Taxpayer did not furnish Accurint or LexisNexis the "case law and other legal materials and publications and/or background information." Rather, that information came from those vendors' databases and compilations. The data resulting from Taxpayer's use consists of standard information furnished to other customers. Taxpayer did not present any documents or other evidence to counter the audit's determination that Taxpayer retrieved information "compiled by a computer [and] sold or reproduced for sale in substantially the same form as it is so produced...." Therefore, pursuant to Sales Tax Information Bulletin 8 (May 2002), 25 Ind. Reg. 3934, the results–by whatever means transmitted–constitute "tangible personal property" obtained in a retail transaction.

FINDING

Taxpayer's protest is respectfully denied as to both its purchases of software licenses and its purchases of online database subscriptions.

II. Sales and Use Tax–Imposition.

DISCUSSION

Taxpayer purchased a number of software maintenance agreements during the Tax Years, whether to complement acquisitions of software programs, or to maintain Taxpayer's use of existing programs and Internet websites. Taxpayer did not pay sales or use tax on these transactions.

Since the Department first issued Sales Tax Information Bulletin 2 on May 2, 1983, computer technology and use has evolved to meet needs and demands. Almost all software optional warranties and software maintenance agreements sold today include the automatic provision of updates, sometimes on a day-by-day or week-by-week basis. Purchasers of these agreements hold a reasonable expectation that they will receive the updates whether or not the actual contract articulates the provision of updates as "optional." The substance of the agreements is that tangible personal property in the form of software updates will be provided no matter what the language of the contract says. The department determines tax consequences by construing the substance of the agreement over the form. Wholesalers, Inc. v. Indiana Department of State Revenue, 597 N.E.2d 1339 (Ind. Tax Ct. 1992). In the case of software maintenance agreements or optional warranties, the parties to the agreements presume that the vendors will transfer tangible personal property in the form of updates to their customers. Therefore, the department will presume that software maintenance agreements and optional agreements are subject to the sales and use tax. A taxpayer could rebut this presumption by demonstrating that no updates were actually received pursuant to a particular maintenance agreement or optional warranty. The Department has remained consistent in this position.

During the hearing, Taxpayer asserted its disagreement with the Department's presumption. However, with the exception of a copy of one purchase agreement, Taxpayer has not presented any additional documents or evidence in support of its argument. Taxpayer has not rebutted the presumption "that tangible personal property in the form of updates will be transferred." Therefore, the software maintenance agreements are subject to use tax.

Going forward, and for Taxpayer's future reference, the Department notes that the most recent version of Sales Tax Information Bulletin 2 (December 2006), 20100804 Ind. Reg. 045100497NRA, (effective August 4, 2010) states in relevant part:

> In the case of software maintenance agreements or optional warranties, the presumption is that tangible personal property in the form of updates will be transferred. Software maintenance agreements and optional warranties **are presumed to be subject to sales and use tax**. This presumption can be rebutted if the taxpayer can demonstrate that no updates were actually received.

FINDING

Taxpayer's protest is respectfully denied.

CONCLUSION

Taxpayer's protest is respectfully denied with respect to its purchases of software licenses and online database subscriptions. Taxpayer's protest with respect to maintenance agreements is also respectfully denied.

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